BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF SOUTHWESTERN PUBLIC SERVICE COMPANY'S APPLICATION FOR REVISION OF ITS RETAIL RATES UNDER ADVICE NOTICE NO. 272,	)	**CASE NO. 17-00255-UT**
SOUTHWESTERN PUBLIC SERVICE COMPANY,	)	
APPLICANT.	)	

STATE OF MISSOURI)
) SS
COUNTY OF ST. LOUIS)

Affidavit of Michael P. Gorman

Michael P. Gorman, being first duly sworn, on her oath states:

1. My name is Michael P. Gorman. I am a Managing Principal with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. We have been retained by Federal Executive Agencies ("FEA") and Louisiana Energy Services, LLC d/b/a URENCO USA ("LES") in this proceeding on their behalf.

2. Attached hereto and made a part hereof for all purposes are my Direct Testimony and attachments which were prepared in written form for introduction into evidence in Case No. 17-00255-UT.

3. I hereby swear and affirm that the testimony and attachments are true and correct and that they show the matters and things that they purport to show.

Michael P. Gorman

Subscribed and sworn to before me this 12th day of April, 2018.

MARIA E. DECKER
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis City
My Commission Expires: May 5, 2021
Commission # 13706793

Maria E. Decker
Notary Public
My commission expires: May 5, 2021

Public Version

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Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017.

Q WHAT IS YOUR OCCUPATION?

A I am a consultant in the field of public utility regulation and a Managing Principal with the firm of Brubaker & Associates, Inc. ("BAI"), energy, economic and regulatory consultants.

Q PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A This information is included as Appendix A to my testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of Louisiana Energy Services, LLC d/b/a URENCO USA ("LES") and Federal Executive Agencies ("FEA"). LES and FEA own and operate facilities in the Southwestern Public Service Company ("SPS" or "Company") service territory.

Q WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS CASE?

A My testimony addresses certain revenue requirement, capital structure, and rate of return issues. I provide an initial summary below before addressing each issue.

I. SUMMARY

Q PLEASE SUMMARIZE SPS'S CLAIMED REVENUE DEFICIENCY.

A SPS has estimated a revenue deficiency including the effects of the change in the federal corporate income tax rate based on the passage of the federal Tax Cuts and Jobs Act ("TCJA") at the end of 2017. This law changed the corporate income tax rate applicable to SPS, and all other investor-owned utilities, from 35% down to 21%. SPS estimates that its revenue deficiency ignoring the change in the federal income tax rate would be $42.5 million, and its revenue deficiency reflecting the TCJA would decrease to $31.1 million, an $11.4 million reduction.[1]

In reflecting the revenue deficiency considering the change in the TCJA, SPS has requested to significantly modify its ratemaking capital

[1] Third Supplemental Direct Testimony of Arthur Freitas at 10.

structure to mitigate the reduction in its internal cash flows and credit metrics caused by the TCJA. SPS proposes to modify its revenue deficiency by increasing its rate of return which increases both cash flow and earnings. Specifically, SPS proposes to adjust its ratemaking capital structure to be based on a 58% common equity ratio, compared to the 53.97% common equity ratio SPS proposed prior to reflection of the TCJA corporate tax rate change. This capital structure change increases SPS's revenue requirement at the new corporate income tax rate by $3.1 million.

Q **PLEASE SUMMARIZE YOUR PROPOSED REVENUE REQUIREMENT ADJUSTMENTS TO SPS'S CLAIMED REVENUE DEFICIENCY REFLECTING THE TCJA.**

A My revenue requirement adjustments reflecting the TCJA are outlined in Table 1 below.

TABLE 1

Revenue Requirement Adjustments
($ Millions)

Description	Amount
Revenue Def. After TCJA	$31.0
Adjustments:	
Capital Structure	$3.1
Return on Equity	$7.1
Prepaid Pension Asset	$3.2
Post-Test Year Plant Additions	$1.9
Tolk Plant Depr.	$2.9
Total Adjustments	$18.2
Adjusted Revenue Deficiency	$12.8

As outlined above, I am recommending $18.2 million of adjustments to the Company's claimed revenue deficiency reflecting the effects of the TCJA. However, I am not endorsing other cost of service components proposed by SPS that I do not specifically address in this testimony. Other parties may have additional appropriate and reasonable adjustments to SPS's claimed cost of service that the Commission should consider in setting just and reasonable rates in this proceeding.

Q PLEASE DESCRIBE YOUR RECOMMENDATION REGARDING THE EFFECTS OF THE TCJA.

A SPS has asserted that it plans to provide the tax expense savings to customers as a reduction to the cost of service in this rate case.[2] I support this commitment as just and reasonable. However, SPS also proposes to increase its common equity ratio, claiming that it must do so because its cash flow and bond rating will be negatively impacted in the 2019-2021 timeframe as a result of the TCJA.[3] I do not support this proposal and recommend it be rejected. SPS's proposal simply retracts the customer savings from the reduced tax rate by increasing customer costs through its more expensive capital structure. SPS's proposal is not warranted under the TCJA as claimed, and should be rejected.

Q PLEASE EXPLAIN WHY YOU ARE PROPOSING TO REJECT THE COMPANY'S PROPOSAL TO INCREASE THE COMMON EQUITY RATIO UNDER THE EFFECTS OF THE TCJA.

A The Company's proposal to increase its common equity ratio to 58% from 53.97% under the effects of the TCJA is without merit. The Company has not commented on the significant cost to retail customers caused by this

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[2] *See* SPS Letter to NMPRC (February 23, 2018) in Case No. 18-00016-UT.
[3] Supplemental Direct Testimony of Brian Van Abel at 3.

proposed change in the ratemaking capital structure. More specifically, SPS's ability to maintain its bond rating without increasing cost to customers is an important issue and SPS has not fully considered the options available if any change in cost of service is needed to support SPS's credit.

There are material factors that may impact SPS's credit metrics over the forecast period that are not related to the TCJA, but are SPS's responsibility and do not warrant the capital structure that SPS attempts to justify solely due to the effects of the TCJA. When the cash flow impacts are isolated to the TCJA, the effects do not justify a change in equity ratio.

While I am rejecting the Company's proposal to increase its common equity ratio up to 58%, this should not be construed as endorsing the Company's proposed capital structure with a 53.97% common equity ratio. Rather, based on a review of regulated utility adjusted debt ratios for credit metrics and normal industry capital structure awards, I believe SPS's proposed capital structure is very expensive and has not been cost justified. However, for purposes of my testimony, I will limit my comment on capital structure to only the reasonableness of SPS's proposal to increase the common equity ratio by 4 percentage points to correspond with the credit metric and cash flow implications of the TCJA.

Q PLEASE EXPLAIN WHY SPS'S PROJECTED CREDIT METRICS ARE NEGATIVELY IMPACTED BY MORE THAN JUST THE TCJA.

A There are several factors that are negatively impacting SPS's projected credit metrics. Those include the following:

1. The TCJA will impact SPS's going forward internal cash flows by reducing incremental amounts of deferred taxes, caused by the reduced federal corporate tax rate, elimination of bonus depreciation, and elimination of deductibility of certain operating expenses. However and importantly, elimination of bonus depreciation does not appear to have a significant impact on SPS's cash flows at least over the forecast period. Specifically, SPS's forecasts under a 54% common equity ratio without the effects of the TCJA reflect an increase of net operating losses starting in 2019, which reduce cash flow from operations and are recorded on the balance sheet of NOL and other tax-related benefits as a current asset. In other words, SPS's taxable income will not be sufficient enough to allow for the use of bonus depreciation and other tax credits recognized by SPS over the forecast period.

2. A significant impact on SPS's credit metrics over the forecast period includes its continued failure to earn its authorized return on equity for its retail jurisdictions served by SPS. SPS's forecasted earned return on equity ranges from around ***[redacted]*** up to around ***[redacted]*** over the forecast period. This compares to authorized returns on equity in Texas and New Mexico of around 9.7%.[4] For Xcel subsidiaries served in multiple jurisdictions, the weighted average authorized return on equity is around 9.6%. Failure to earn its authorized returns on equity decreases SPS's net income, cash flows, and negatively impacts its credit metrics.

3. The substantial investment SPS proposes to make in wind generation approved in Case No. 17-00044-UT will have a temporary negative effect on SPS's projected cash flows during the 2019-2021 period, but will have positive impact on cash flows later as SPS is able to use

[4] Xcel Energy, Investors Presentation, March 26, 2018 at 37.

deferred PTCs to reduce current tax expense. These wind resources are expected to be in-service in or around 2019 and 2020.

In the Stipulation on the wind projects, SPS agreed to pass the Production Tax Credits ("PTC")associated with the wind generation on to customers even if they cannot realize the tax savings in the year those PTCs are earned. The Stipulation allows SPS to defer these ratepayer PTC credits in a regulatory account and carry them forward until SPS actually has the taxable income that can use the PTCs. The net effect of this under the terms of the settlement is that it will have a negative impact on SPS's cash flows during the period 2019-2021 but will positively impact its cash flows later when SPS has taxable income that can be charged against the deferred PTC NOL assets.

Q PLEASE DESCRIBE YOUR PROPOSED ADJUSTMENT TO THE PREPAID PENSION ASSET.

A SPS has failed to prove that the prepaid pension asset was funded by investor capital rather than customer contributions paid to SPS to fund pension trust contributions. A return on a prepaid pension asset should only be permitted if the utility proves that the prepaid pension asset was funded by investor capital, and the existence of the prepaid pension asset reduces pension cost to customers, including the cost of return on the prepaid pension asset. SPS has not made such a proof in this case, but rather states that this proof is not possible. For these reasons, SPS's prepaid pension asset should be excluded from rate base, because the Company simply has not proven that investors are entitled to a return on this investment. Further, to the extent this investment produces benefits to retail customers, retail customers are already entitled to those benefits to the extent they funded the prepayment of the pension asset that caused these savings to be realized. For these reasons, customers should not be asked to compensate SPS and its investors for benefits that were realized through customer capital as opposed to investor capital.

Q PLEASE DESCRIBE YOUR ADJUSTMENTS TO SPS'S PLANT ADDITIONS FROM THE END OF THE TEST YEAR (JUNE 30, 2017) TO THE NOVEMBER 30, 2017 POST-TEST YEAR PERIOD.

A SPS's original filing was based on the projection that it would place approximately $44.0 million of additional plant in New Mexico retail allocated in service by November 30, 2017, a 5-month period extending beyond the end of the historical test year ending June 30, 2017. However, the Company failed to meet that objective. Instead, SPS placed in service approximately $28.5 million of plant in-service by November 2017, on a New Mexico retail basis. Adjusting SPS's cost of service in this proceeding to reflect the actual amount of plant in-service it accomplished by November 2017 reduces its net plant in-service by approximately $15.4

million, and reduces the revenue requirement by approximately $1.9 million[5] on a New Mexico-Texas retail basis.

Q PLEASE DESCRIBE YOUR ADJUSTMENT TO THE TOLK GENERATING STATION INCREASED DEPRECIATION EXPENSE.

A SPS is proposing to accelerate the recovery of its Tolk generating plant investment in this proceeding. SPS proposes to fully recover the Tolk plant investment by 2032 rather than the current depreciation rate schedule extending through 2042. Accelerating recovery of the Tolk plant increases SPS's New Mexico retail depreciation expense and revenue requirement by $2.93 million.

The Company's proposal to accelerate the recovery of the Tolk plant investment has not been shown to be a prudent planning decision. SPS's planning studies do not show early retirement of Tolk as an economic resource decision, and SPS has not resolved important resource planning consequences in the event Tolk is retired. That is, the retirement of Tolk in 2031 will require additional investments needed for voltage stability in areas supported by the Tolk plant. SPS simply has not determined the

[5]$15.4 million x 8.38% (Attachment MPG-21) = $1.3 million, plus $15.4 million x estimated depreciation rates (MPG Workpapers) = $600,000.

lowest cost option of resolving these voltage stability concerns, including either maintaining operation of Tolk through its current plant operating life, or retiring it early and installing new investments to support voltage stability in areas affected by the Tolk early retirement.

For these reasons, early retirement of the Tolk facility has simply not been proven to be a prudent resource planning decision.

Further, SPS has not provided a written notification to the SPP for its decision to retire the Tolk plant to the Southwest Power Pool ("SPP") by 2032. Therefore, the SPP has not responded to SPS's proposal for the early retirement of the Tolk plant.[6]

For all these reasons, SPS's proposal to accelerate recovery of the Tolk facility is simply premature, not based on prudent planning decisions, and is not shown to be a cost justified adjustment to the expected operating life of the Tolk facility nor a prudent planning decision.

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[6] SPS response to LES 3-4, included in Attachment MPG-2.

Q **PLEASE DESCRIBE YOUR FINDINGS ON A FAIR AND REASONABLE RETURN ON EQUITY FOR SETTING SPS'S RATES IN THIS PROCEEDING.**

A I recommend the New Mexico Public Regulatory Commission (the "Commission" or "NMPRC") award SPS a return on common equity of 9.10%, which is above the midpoint of my estimated range of 8.70% to 9.50%. My recommended return on equity will fairly compensate SPS for its current market cost of common equity, and it will mitigate the claimed revenue deficiency in this proceeding by fairly balancing the interests of all stakeholders.

The overall rate of return produced by my recommended return on common equity, and my ratemaking capital structure for SPS produces an overall rate of return of 6.99%, as shown on my Attachment MPG-1.

Finally, I will show that SPS witness Ms. Bulkley's recommended range of 9.75% to 10.50%, and her point estimate of 10.25%, are excessive and unreasonable, and should be rejected.